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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of)

Local Exchange Carriers' Rates,)
Terms, and Conditions for Expanded)
Interconnection Through Virtual)
Collocation for Special Access and)
Switched Transport)

CC Docket No. 94-97, Phase I

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RESPONSE TO PHASE I DIRECT CASES BY THE
ASSOCIATION FOR LOCAL TELECOMMUNICATIONS SERVICES

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SUMMARY

The Direct Cases submitted by the five RBOCs which have chosen to rely solely on virtual collocation for expanded interconnection -- Ameritech, Bell Atlantic, Bell South, Southwestern Bell, and US West -- appear to have adopted a common stance. They all reflect the apparent belief that so long as they keep objecting to the Commission's standard for the allocation of overheads to expanded interconnection services, they can always count on a subsequent opportunity to submit a "real" defense.

The time has come to blow the whistle on this procedural intransigence. The Commission has made it perfectly clear on numerous occasions that the overheads the LECs allocate to expanded interconnection services cannot exceed those applied to comparable offerings, absent justification. This standard is clear, fair, and essential to the future of competitive telecommunications. The RBOCs should not be allowed to continue playing "dumb and dumber" with the Commission's overhead allocation standard by pretending it does not exist, or can be safely ignored.

Specifically, ALTS requests that the Commission:

- Order the five RBOCs which do not provide physical collocation to immediately refile their virtual collocation tariffs using overheads for each tariff element which are no higher than the lowest overhead used for comparable functionalities or rate elements;

- Order the five RBOCs to promptly resubmit their Phase I cases showing:
 - A complete and non-confidential listing at a granular level of all the functions included in their virtual interconnection services, both special and switched;
 - A complete listing of all overhead loadings applied to similar functionalities, regardless of the technical similarity of the overall service to virtual collocations, or its duration, or the jurisdiction in which it happens to be tariffed; and,
 - A full explanation of any reasons why the functionalities which are part of an RBOC's virtual collocation tariffs should not reflect the lowest of all overheads attributed to the same function in any other service offering by that RBOC.

Policing the LECs' allocation of overheads to their expanded interconnection offerings for anti-competitive intent should be among the Commission's most central tasks. ALTS respectfully asks that the Commission take on this role vigorously by making the current overhead Rate Adjustment Factors ("RAFs") permanent, and pushing for a prompt and authoritative resolution of this critical issue.

TABLE OF CONTENTS

SUMMARY	i
TABLE OF CONTENTS	iii
I. ALTS' INTEREST IN THIS PROCEEDING AND THESE TARIFFS	1
II. THE RBOCS SHOULD NOT BE ALLOWED TO CONTINUE DISREGARDING THE COMMISSION'S STANDARD FOR ALLOCATING OVERHEADS TO EXPANDED INTERCONNECTION SERVICES	2
A. The Commission's Standard for Allocating Overheads to Expanded Interconnection Services Is -- Or Should Be -- Clear to the LECs	2
B. The RBOCs Are Also Subject to Scrutiny of Their Overhead Allocations Under the MFJ	5
C. The "Confidentiality" Requests of the RBOCs are Inconsistent with their Obligations under the Communications Act, the Antitrust Laws, the MFJ, and the Commission's Rules for New Service Offerings	8
III. SPECIFIC RBOC RESPONSES	10
A. Ameritech	10
B. Bell Atlantic	12
C. Bell South	14
D. Southwestern Bell	15
E. US West	16
CONCLUSION	18

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RESPONSE TO PHASE I DIRECT CASES BY THE
ASSOCIATION FOR LOCAL TELECOMMUNICATIONS SERVICES

The Association for Local Telecommunications Services ("ALTS"), pursuant to the Order Designating Issues for Investigation released February 28, 1995, in this docket ("Virtual Designation Order"), hereby responds to the Direct Cases filed March 21, 1995, by the five regional Bell holding companies which have declined to continue physical collocation, and which instead provide expanded interconnection exclusively through virtual collocation -- Ameritech, Bell Atlantic, Bell South, Southwestern Bell, and US West.

I. ALTS' INTEREST IN THIS PROCEEDING AND THESE TARIFFS

ALTS is the non-profit national trade organization representing competitive providers of local telecommunications services. ALTS' membership include over twenty-seven non-dominant providers of competitive access and local exchange services which deploy innovative technologies in many

metropolitan and suburban areas across the country. ALTS, as well as several of its individual members, participated actively in the Commission proceedings which gave rise to the tariff filings under examination here (Expanded Interconnection with Local Telephone Company Facilities, CC Docket No. 91-141), and ALTS' members will be among the first to order services pursuant to these tariffs.

II. THE RBOCS SHOULD NOT BE ALLOWED TO CONTINUE DISREGARDING THE COMMISSION'S STANDARD FOR ALLOCATING OVERHEADS TO EXPANDED INTERCONNECTION SERVICES.

A. The Commission's Standard for Allocating Overheads to Expanded Interconnection Services Is -- Or Should Be -- Clear to the LECs.

It is manifestly apparent from the ever-lengthening history of the Commission's involvement with expanded interconnection that the issue of the proper level of overhead loading was resolved long ago. Unfortunately, the Direct Cases filed on March 21, 1995, by the five RBOCs which provide expanded interconnection exclusively through virtual collocation act as though they never heard of the underlying issue.

Indeed, trying to make the local exchange companies ("LECs") provide an intelligible account of their overhead loadings has been a struggle throughout the Commission's long effort to inject competition into telecommunications markets. In 1993, the Common Carrier Bureau tried to conduct a commonsense comparison of the expanded interconnection overhead loadings with loadings for DS-1

and DS-3 services.¹ It issued a designation order requiring the LECs to submit detailed, disaggregated overhead data for each comparable service, and expressly included all generic DS-1 and DS-3 services, as well as discounted volume and term pricing plans.² As the Bureau acknowledges in its present Virtual Designation Order (at ¶12): " ... the Bureau did not receive adequate overhead loading data regarding comparable services"

Given its inability to obtain the required data, the Bureau used the Commission's Virtual Interconnection order in July of 1994³ to underscore the importance of this information through a tariff review order:

"Overhead cost factors. To enable us to evaluate the reasonableness of overhead amounts included in expanded interconnection service (EIS) rates, LECs must submit the following information regarding the overhead loadings for EIS and comparable services: LECs must provide the overhead factors used for each EIS rate element, identify the cost basis for these factors, explain how the factors were derived from that basis, and justify the reasonableness of the factors....

"LECs also must provide, on a service-by-service basis, overhead factors for all point-to-point DS1 and DS3 special access services offered. In addition, overhead factors must be provided on a service-by-service basis for all DS1 and DS3 switched transport services if the rates for these switched services differ from the special access rates. For the purposes of this request, these special access and switched services for which overhead factors must be listed are not limited to the generic electrical and optical service. They

¹ Special Access Physical Collocation Tariff Suspension Order, CC Docket No. 93-152, 8 FCC Rcd (1993).

² Special Access Physical Collocation Designation Order, CC Docket No. 93-152, 8 FCC Rcd 6909 (1993).

³ Expanded Interconnection with Local Telephone Company Facilities, CC Docket No. 91-141, FCC Rcd 5154 (1994).

also include the discounted volume and term services; channel termination services; interoffice services comprised of channel termination and channel mileage; and any specialized service offerings, e.g., self-healing network services"⁴
(Emphasis supplied.)

The data submitted by the LECs in support of their virtual collocation tariffs demonstrated no consistency in their allocation of overhead costs to high capacity services in comparison with their expanded interconnection services:

"The information submitted by the LECs in support of their proposed rates shows substantial differences between the loading factors they propose to apply to their charges for expanded interconnection services and those currently applied to comparable services Based on the LECs' statements and submitted cost data, we conclude that the great disparity exhibited in overhead loading primarily reflects market conditions."⁵

Based on this disparity in allocations, the Bureau suspended the LECs' virtual collocation rates to the extent they recovered overhead allocations in excess of those recovered by comparable services, absent justification.⁶ On February 28, 1995, the Virtual Collocation Designation Order required the LECs to provide that justification.

Unfortunately, the Direct Cases filed by the LECs on March 21st continue to pretend this clear and unambiguous requirement somehow does not exist, or does not apply to term and volume

⁴ Tariff Review Plan Order, released July 25, 1994, DA 94-819, ¶¶11-12, footnotes omitted.

⁵ Virtual Collocation Tariff Suspension Order, CC Docket No. 94-97, released December 9, 1994, ¶¶ 20-21.

⁶ Id. at ¶ 16.

discounts, or does not apply to market-determined rates, etc. These arguments are not only unsound and untimely, they are an obvious attempt to resist an obligation which has existed for at least two years: to explain why expanded interconnection overhead allocations should ever exceed the overheads allocated to other comparable services.

The time for such disingenuous evasions is long past. As shown below, the RBOCs which rely exclusively on virtual collocation for expanded interconnection have failed to justify their proposed overhead loadings. Each carrier should be required to: (1) certify they have identified all overhead loadings in all service offerings containing any functionality also found in expanded interconnection; and (2) recalculate and republish their expanded interconnection rates to reflect the lowest overhead applied to any comparable functionality or rate element.

B. The RBOCs Are Also Subject to Scrutiny of Their Overhead Allocations Under the MFJ.

There is nothing novel or unique about the Commission's attempt to analyze the possibility of predatory pricing in its review of overhead loadings. Indeed, the same concern is also reflected in the requirements of the Modification of Final Judgment ("MFJ"). Unfortunately, the RBOCs in general, and US West in particular, absolutely refuse to acknowledge that they bear any MFJ-compliance obligations in their dealings with the

FCC.⁷

US West's intransigence is alarming, given that US West is already subject to an Enforcement Order based on its violation of the MFJ in precisely the fashion that may well be involved here. US West attempted to sell its ETS switching services to the GSA in competition with AT&T's CCSA switching services by trying to assess its own service only a surcharge for off-network calls, while charging AT&T's service the more expensive Feature Group A rates for the equivalent functionality. See United States v. Western Electric, 846 F.2d 1422 (D.C. Cir. 1988).

The same situation could be presented here, but with even more serious implications. If US West has in fact attempted to justify unreasonably high IDE prices by excessive overhead

⁷ In reviewing the September 1, 1994, virtual collocation tariff filings, ALTS asked US West to explain the derivation of certain numbers set forth in its Exhibit A, and also asked whether the methodology and specific amounts reflected in Exhibit A were identical to the methodology and specific amounts for those same functions recovered in US West's tariffs for competitive services (November 30, 1994, letter from R.J. Metzger).

US West's reply of December 5, 1994, refused to address the issue of US West's compliance with the MFJ:

"You seek to ascertain information that is not part of the public record in this proceeding; was not information that US WEST was required to provide as part of its general tariff filings or support for its Virtual Expanded Interconnectio ("VEIC") service; is not information that U S WEST is required to provide with respect to its tariff support for other products and services; and which appears to be sought for purposes wholly unrelated to the instant Expanded Interconnection proceeding. In that light, I believe U S WEST is required to be fairly circumspect with respect to its responses to you organization." (Emphasis supplied.)

allocations, such a practice would "strike at the MFJ heart" in just the same way that US West's attempt to impose different rates for competitive off-net services did (846 F.2d at 1428). And the present situation would be even more serious, since it could foreclose not just a single sale, as was the case with the GSA contract, but could preclude competition over a wide range of services from potential interconnectors.

US West's contentions that there are no "comparable services" are paralleled by the GSA case, where US West attempted to argue that off-network access from its ETS service was subject to different regulatory treatment than AT&T's CCSA service. Both the District Court and the Court of Appeals flatly rejected such regulatory distinctions as a defense to an MFJ violation (846 F.2d at 1426, 1430), and are even more alarming given US West's defiance of the FCC's Virtual Interconnection order, where the Commission itself repeatedly refers to "comparable" internal LEC interconnections (see, e.g., ¶¶42, 44, 54, 57, 61, 95).⁸

⁸ See also Section IV (I) of US West's Enforcement Order which expressly requires that such an analysis be made for all new services:

"It is further ordered that US West's own internal formal process for reviewing business practices shall include any new products US West desires to offer to its end users and/or competitors, including any existing product whose underlying cost methodology, pricing, or interconnection terms or conditions are substantially modified."

C. The "Confidentiality" Requests of the RBOCs are Inconsistent with their Obligations under the Communications Act, the Antitrust Laws, the MFJ, and the Commission's Rules for New Service Offerings.

Just as occurred with the original virtual collocation tariffs, SWB (and now also Ameritech) have sought confidentiality protection for some of their supporting data. At the heart of the problem, in ALTS' understanding, is SWB's contention that its equipment prices reflect negotiated vendor prices which are confidential and cannot be disclosed without the vendor's consent (September 19th reply comments of SWB to TCG FOIA request at 3; September 22d reply to MFS FOIA request at 2). SWB further argues that the publicly available prices are "catalog" prices which are higher than those enjoyed by SWB, and that interconnectors would only hurt themselves by compelling disclosure (*id.* at 6).

Without any discourtesy to SWB's undoubted purchasing skill, the Commission need only look at plain business reality to understand that SWB has no sound basis for seeking confidentiality. There is absolutely nothing about SWB's network, its volume of purchases, its negotiating skill, or any other factor that puts SWB in a position to capture unique vendor prices. And even if there were, the ordinary business practice in procurement situations is to obtain "most favored nation" status, which assures the purchaser of identical treatment should any similar customers receive better prices from the vendor in the future. The contention that SWB somehow enjoys "special" prices from its vendors that are not available to similarly-situated

customers thus defies ordinary business practice and common sense. True, the existence of such arrangements does encourage vendors to seek confidentiality, and thereby minimize the risk of other customers invoking their "most favored nations" clauses (as is well demonstrated by the vendor letters attached to SWB's September 19, 1994, response to TCG), but SWB cannot escape its regulatory obligations by hiding behind its vendors' contractual exposure.

Equally troubling is SWB's claim this data "is merely a tool to assist the Commission," and that "[t]he Commission is capable on its own of examining the prices listed in the cost support and the input of third parties would be of no assistance" (*id.* at 9). This is a blatant misportrayal of the tariff review process as it has existed throughout the Commission's six-decade history. At no time has the Commission had the appropriations, the person-power, or the access to ordinary business systems and expertise that would be needed to independently verify each and every datum that may be contained in the immense stack of filings submitted on September 1, 1994. Instead, the Commission has always relied upon the comments of informed intervenors in deciding how to allocate its own limited resources for the purpose of tariff review. SWB's position would completely overturn this traditional process.

The refusal of SWB and Ameritech to provide data required by

the Virtual Collocation Designation Order is particularly telling in light of the Commission's determination that the expanded interconnection service offerings would be treated as "new services," thereby requiring cost support. This requirement is meaningless if the required data is concealed from the public. SWB and Ameritech should both be required to produce this data immediately, and any applicable RAFs should remain in effect pending its submission and the Commission's ultimate disposition of this issue.

III. SPECIFIC RBOC RESPONSES

A. Ameritech

Comparable Services. Ameritech argues that the "list of comparable services ... should not be greater than the list of those services offered by the LEC which are also being offered by the CAP ... " (Direct Case at 2). There are two fundamental errors in this contention. First, the "price squeeze" threat which Ameritech acknowledges as a policy concern is not limited to only those services offered by a competitive provider which are identical to LEC services in terms of technical specifications. A "price squeeze" is a market weapon, not a technical matter, and the markets solely concern themselves with the substitutability of various products. While ordinary POTS voice channels may not be comparable, for many customers the various high capacity services are simply commodity offerings that differ principally according

to price.

Ameritech's second error is assuming that its analysis need only deal with the product offering level, rather than also the functionality level. True, there may not be the immediate "price squeeze" issue in the situation of inconsistent loadings for identical functionalities when those functionalities are contained within products with low cross-elasticity with expanded interconnection services. However, the near-term likelihood of greatly increased unbundling for the LECs strongly suggests the Commission should push its analysis to the functional level now, rather than wait until unbundling creates additional anti-competitive opportunities for the LECs.

Comparison of Overhead Loadings. Ameritech deserves recognition for being virtually the only RBOC to acknowledge that "The Commission has a legitimate interest in protecting a CAP from being put in a price squeeze by a LEC in those situations in which the CAP must subscribe to certain LEC services in order to provide an offering that competes with the LEC" (Direct Case at 5-6). However, Ameritech goes on to argue that its rates which are determined by the market do not contain overhead allocations, only "margin" (id. at 7).

But this is a distinction without a difference. Call it "margin" or call it "allocation of overhead," the risk of a price

squeeze conceded by Ameritech obligates the LECs to calculate the implied overhead for market-driven rates as well, and then apply those percentages in calculating expanded interconnection rates if they are lower than the allocations currently used.

Ameritech also makes the argument that the total margin recovered from comparable services need only equal the total margin on an expanded interconnection service in order to preclude price squeezes (Direct Case at 7). While Ameritech's test might define an absolute minimum price floor in a perfectly competitive world, that is definitely not the world the RBOCs currently operate in. As evidenced by their loud assertions of continued earnings regulation in the wake of the Commission's recently announced changes in price cap regulation, the RBOC's have ample alternative opportunities to recover implicit "margin" from changes in their refund liability, basket shifts, and many other consequences resulting from their underpricing of competitive offerings.⁹

Confidential Cost Treatment. Ameritech's request for confidential treatment of its submission is unsupported for the reasons described supra at pp. 8-10.

B. Bell Atlantic

⁹ See also DOJ's recent refusal to agree that current price cap regulation is sufficient to preclude LEC incentives to cross-subsidize in recommending a RHC royalty waiver to Judge Greene.

Comparable Services. Bell Atlantic makes no serious effort to comply with the Virtual Collocation Designation Order in its Direct Case. For example, Bell Atlantic claims that (Direct Case at 1): "The overhead loading factor used for that [September 1] filing is designed to capture the same proportion of indirect costs that other services in the same service category incur." But, as shown above, the Commission has made it unmistakeably plain that the issue is not one of regulatory category, but rather predatory effect. This attempt to pretend that protection of competition has no role before the Commission is transparent, and should be dispelled.

Indeed, Bell Atlantic goes so far as to indulge in the long-discredited contention that "prior Commission approval" insulates it from scrutiny for competitive effects (Direct Case at 8): "Bell Atlantic's use of a Commission-requested standard overhead loading methodology cannot reasonably be considered an impediment to competition." Putting aside the accuracy of Bell Atlantic's claim it applies a "Commission-requested standard," the antitrust courts have long held that Commission approval does not insulate a regulated entity from the consequences of anti-competitive action.¹⁰

Bell Atlantic also indulges itself in a rather lengthy

¹⁰ MCI v. AT&T, 708 F.2d 1081, 1103-1105 (1983).

discussion of why it believes that no "direct correlation exists between interconnection services and channel termination services" (Direct Case at 4-5). Boiled down to its essentials, Bell Atlantic first claims that it provides services, not facilities (*id.* at 5). Of course this is true, but irrelevant. The issue is whether the same functionalities are used in comparable services, and the level of the overhead allocation applied to them. Second, Bell Atlantic argues strenuously that the facilities used in connection with expanded interconnection are different than those employed in "comparable services" (*id.* at 4-6).

Assuming for the moment Bell Atlantic is correct there are nuanced distinctions between the various facilities used by expanded interconnection and comparable services, Bell Atlantic still has not proven its point. Expanded interconnection services may indeed use different risers, occupy different floors, and employ different order forms. But the relevant question is why such distinctions should require different overhead loadings. To put the matter bluntly, Bell Atlantic cannot flyspeck expanded interconnection services for subtle differences in their provisioning which have no market implications, use those distinctions to slap a "special" label on the expanded interconnection facilities, and then claim it is immune to any comparison or analysis.

C. Bell South

Comparable Services. Bell South's position merits little discussion. Nowhere does it acknowledge the danger of predatory pricing, and, having turned a blind eye to the fundamental issue, it predictably contends there is no such thing as a "comparable service" (Direct Case at 2-3). Rather than address the competitive issues, Bell South trumpets its fidelity to good old fashioned regulatory pricing (Direct Case at 4): "Bell South does not -- and at this time, cannot -- offer geographically deaveraged rates." This troglodytic approach to the well-established and well-settled issue of predatory pricing -- an issue which even Ameritech acknowledges the Commission must address -- is tedious and should be rejected.

D. Southwestern Bell

Comparable Services. Southwestern Bell's approach in its Direct Case resembles Bell South in that it refuses to ever confront the underlying issue -- the need to demonstrate that any lower allocations of overheads to its own comparable services and functionalities is evidence of predatory intent. Rather than address the real issue, it bangs the drum about the Bureau's asserted attempt "to take business from one company and give it to others ..." (Direct Case at 3). And, after refusing to recognize the real purpose of its direct case, Southwestern predictably argues that "comparable services" should be determined using "the group of rate elements that are most technically equivalent to

virtual collocation" (id. at 5).

Confidential Cost Treatment. SWB's request for confidential treatment of its submission is unsupported for the reasons described supra at pp. 8-10.

E. US West

Comparable Services. US West's position on comparable services is certainly clear (Direct Case at 2): "In US West's opinion, there are no additional common carrier services that are comparable to our VEIC services." Unfortunately, US West's judgment on such matters is not perfect, since, as noted above, it contended that the ETN service it offered GSA was not comparable to AT&T's CCSA service for purposes of the charges that GSA would have to pay for off-net access (supra at pp. 5-7).¹¹

For example, US West unilaterally excludes its Self Healing Alternate Route Protection ("SHARP") service from comparable rates, despite the Tariff Review Order's express inclusion of "self-healing network services" (id. at ¶12). According to US West (Direct Case at 4):

"We do not consider SHARP and interoffice mileage to be comparable to the Virtual EICT due to the different service provisioning configurations. SHARP and interoffice mileage

¹¹ US West goes so far as to assert that " .. one cannot be asked to 'defend' a proposition that one deems illegitimate" (Direct Case at 9). On the contrary, it is fundamental in a system of law that all parties will comply with outstanding legal requirements, including those they believe to be unfounded or "illegitimate."

are provisioned from fiber terminating equipment located in the wire center and terminated at equipment at a customer's premises, or in the customer's serving wire center, respectively. The EICT, on the other hand, is a facility provisioned from the IDE located in the wire center to US West's digital cross-connect equipment also located in the wire center."

Once again, these alleged distinctions are of no significance to the issue at hand unless they render the LEC service non-comparable from the viewpoint of the customer. Until US West can offer a reason why the market cares about these distinctions, this is just so much techno-blather.

CONCLUSION

The Commission should be applauded for its recognition that overallocation of overheads to virtual collocation services poses a serious threat to the successful introduction of telecommunications competition. Unfortunately, it is apparent from the Direct Cases that a truly meaningful review of overheads is impossible so long as the RBOCs remain free to ignore the economic reality of their pricing decisions.

It is time for the Commission to put an end to the pointless and embarrassing regulatory camouflage being employed by the RBOCs. It should require that the functions employed for virtual collocation be broken out at a highly granular level, and that all similar functions contained in any service -- similar or dissimilar, Federal or state, prescribed, carrier-initiated, or "market-driven" -- be fully described, along with their implicit or explicit overhead loadings.

Specifically, ALTS requests that the Commission:

- Order the five RBOCs which do not provide physical collocation -- Ameritech, Bell Atlantic, Bell South, Southwestern Bell, and Pacific -- to immediately refile their virtual collocation tariffs using overheads for each tariff element which are no higher than the lowest overhead shown for comparable rate elements and functionalities in their direct cases;
- Order the five RBOCs to promptly resubmit their Phase I cases showing:
 - A complete listing at a granular level of all the functions included in their virtual interconnections

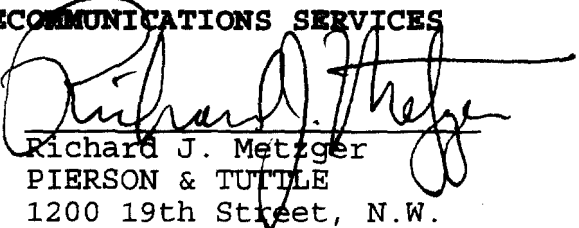
services, both special and switched;

- A complete listing of all overhead loadings applied to similar functionalities, regardless of the similarity of the overall service to virtual collocations, or its duration, or the jurisdiction in which it is tariffed;
- Any reasons why the functionalities included in an RBOC's virtual collocation tariffs should not reflect the lowest of the overheads attributed to the same function in any other service offering by that RBOC.

Respectfully submitted,

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April 4, 1995

CERTIFICATE OF SERVICE

I hereby certify that on this 4th day of April, 1995 copies of the foregoing
RESPONSE OF THE ASSOCIATION FOR LOCAL TELECOMMUNICATIONS SERVICES
were served via hand delivery* or first class mail, postage prepaid, to the parties listed on the
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